DEPARTMENT OF STATE REVENUE

04-20140555.LOF

Letter of Findings Number: 04-20140555
Use Tax
For Tax Years 2010-12

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Retail business established that some of the transactions initially determined to be taxable were actually not taxable. Therefore, the Department's calculations of use tax which should have been remitted were incorrect. The Department's proposed assessments for use tax will be recalculated.

ISSUES

I. Use Tax–Exempt Transactions.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-7; IC § 6-2.5-5-16; IC § 6-8.1-5-1; Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Galligan v. Indiana Dep't of State Revenue, 825 N.E.2d 467 (Ind. Tax 2005); Frame Station, Inc. v. Indiana Dep't of State Revenue, 771 N.E.2d 129 (Ind. Tax Ct. 2002); 45 IAC 2.2-3-4; 45 IAC 2.2-3-12; 45 IAC 2.2-4-26; Sales Tax Information Bulletin 60 (April 2011).

Taxpayer protests proposed assessments for additional use tax.

II. Tax Administration–Penalties.

Authority: IC § 6-8.1-5-4; IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of penalties.

STATEMENT OF FACTS

Taxpayer is an Indiana paving business. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on all taxable purchases for the tax years 2010, 2011, and 2012. The Department therefore issued proposed assessments for use tax, penalty, and interest for those years. Taxpayer protests that the Department's adjustments are not accurate. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Exempt Transactions.

DISCUSSION

Taxpayer protests the Department's proposed assessments of use tax for the tax years 2010-12. Due to the large number of transactions, the Department used a sample and projection method to review Taxpayer's purchases for the tax years 2010, 2011, and 2012. The Department reviewed the purchases in the sample population and determined the percentage of taxable purchases in the sample population. That percentage was considered to be Taxpayer's overall taxable percentage on its purchases and it was applied to Taxpayer's total purchases for all three years. Credit was given for sales and use tax already remitted and the remainder was considered use tax due. Taxpayer protests that some of the items considered taxable in the sample population were either exempt or had already had sales and/or use tax paid. By reclassifying these purchases, Taxpayer states that the taxable percentage of the sample population would be reduced and that in turn would reduce the taxable percentage of purchases overall.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing. . .[courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Sales tax is imposed by IC § 6-2.5-2-1, which states:

> (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
> (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Use tax is imposed under IC § 6-2.5-3-2(a), which states:

> An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

45 IAC 2.2-3-4 further explains:

> Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when sales tax is not paid at the time TPP is purchased, use tax will be imposed unless the purchase is eligible for an exemption.

In the instant case, Taxpayer protests that certain purchases listed as taxable and with tax due in the sample population were actually either exempt or had already had tax paid. Among the transactions at issue, the first are items purchased for a paver which Taxpayer states is exempt. The relevant statute is IC § 6-2.5-5-3(b), which states:

> Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

Also of relevance is 45 IAC 2.2-4-26(e), which provides:

> Utilities, machinery, tools, forms, supplies, equipment or any other items used by or consumed by the contractor and which do not become a part of the improvement to real estate are not exempt regardless of the exempt status of the person for whom the contract is performed.

Taxpayer refers to Sales Tax Information Bulletin (April 2011) 60 20110427 Ind. Reg. 045110247NRA ("Information Bulletin 60"), which provides in relevant part:

> Asphalt manufacturers are entitled to a manufacturing exemption for sales and use taxes (under Indiana Code IC 6-2.5-5) for the asphalt plant and pavers, including repair parts and fuel for the respective equipment. Asphalt manufacturers are granted an exemption from sales and use taxes for dump trucks used to transport "hot mix asphalt" from their asphalt plant to the job site.

After review of the relevant statutes, regulations, and Information Bulletin 60, the Department agrees that the asphalt plant and pavers will be considered exempt for this audit period. Specifically, IC § 6-2.5-5-3(b) provides

that the machinery, tools, and equipment a taxpayer purchases will be exempt from sales tax if the machinery, tools, and equipment are directly used in the direct production of other tangible personal property. In this case, the asphalt is the other personal property which is produced, therefore the asphalt plant equipment and machinery are exempt under IC § 6-2.5-5-3(b).

Notably, 45 IAC 2.2-4-26(e) provides that the equipment used by a contractor in the course of making an improvement to realty are not exempt regardless of the exempt status of the person for whom the contract is performed. In this case, Taxpayer used the pavers to make improvements to realty. Therefore, under 45 IAC 2.2-4-26(e), the pavers are not exempt. However, since the Department stated in Information Bulletin 60 that pavers were exempt, the Department will agree that the pavers and the parts purchased as repair parts for the pavers are not subject to sales and use taxes for this audit period.

The Department takes this opportunity to clarify and affirm that Information Bulletin 60 is incorrect when it states that pavers are exempt from sales and use taxes. Plainly, under 45 IAC 2.2-4-26(e) pavers are not exempt since they are machinery used to make improvements to realty which do not become part of the improvement to realty. In fact, Information Bulletin 60 correctly states that no exemption is available for graders, rollers, distributors, front-end loaders, and other construction equipment. These items are all used in manners similar to the manner of use of the pavers. Therefore, as of the date of publication of this Letter of Findings no taxpayer may rely on the statement in Information Bulletin 60 which states that pavers are exempt from sales and use taxes.

Taxpayer's next point of protest is in regards to storage tank rentals. The Department considered the rental of the storage tanks to be the rental of tangible personal property which is subject to sales tax or use tax. Taxpayer protests that the storage tanks are located in another state and are therefore not subject to Indiana taxes. In the course of the protest process, Taxpayer was able to provide documentation establishing that the storage tanks are indeed located outside Indiana's borders. Therefore, since Taxpayer did not use, store, or consume the tangible personal property in Indiana, use tax is not due on those rentals as provided by IC § 6-2.5-3-2(a).

Taxpayer's next point of protest is in regards to tangible personal property it used in performing paving services for a municipality in Indiana. Taxpayer states that the project in question was for a governmental entity and that, since the governmental agency would be exempt from sales and use taxes, its purchases relating to the project would also be exempt from sales and use taxes. The relevant statute is IC § 6-2.5-5-16, which provides:

> Transactions involving tangible personal property, public utility commodities, and public utility service are exempt from the state gross retail tax, if the person acquiring the property, commodities, or service:
> (1) is the state of Indiana, an agency or instrumentality of the state, a political subdivision of the state, or an agency or instrumentality of a political subdivision of the state, including a county solid waste management district or a joint solid waste management district established under IC 13-21 or IC 13-9.5-2 (before its repeal); and
> (2) predominantly uses the property, commodities, or service to perform its governmental functions.
> (Emphasis added).

The relevant regulation is 45 IAC 2.2-3-12, which states:

> (a) Tangible personal property purchased to become a part of an improvement to real estate under a contract with an organization entitled to exemption is eligible for exemption when purchased by the contractor.
> (b) In order to be exempt on such purchases, the contractor must be registered as a retail merchant, must obtain an exemption certificate from the exempt organization, and must issue an exemption certificate to his supplier.
> (c) Utilities, machinery, tools, forms, supplies, equipment, or any other items used or consumed by the contractor and which do not become a part of the improvement to real estate are not exempt regardless of the exempt status of the person for whom the contract is performed.
> (d) A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchaser [sic.] price of all material so used.
> (e) A person selling tangible personal property to be used as an improvement to real estate may enter into a completely separate contract to furnish the labor to install or construct such improvement, in which case the sales tax shall be collected and remitted by such seller on the materials sold for this purpose. Such sale of materials must be identifiable as a separate transaction from the contract for labor. The fact that the seller subsequently furnished information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material.
> (Emphasis added).

After a review of the audit report's listing of the sample population transactions, and of the documentation provided by Taxpayer in the course of the protest process, the transactions in question do qualify for the exemption listed under 45 IAC 2.2-3-12(a). The transactions were for concrete purchased from a third-party vendor. The concrete was incorporated into realty owned by a political subdivision of Indiana, which in this case was an Indiana city. Therefore, Taxpayer has met the burden of proving the proposed assessment wrong, as required by IC § 6-8.1-5-1(c).

Taxpayer's next point of protest is in regards to a project it undertook involving the paving of streets in a neighborhood which was to become part of an Indiana city. Taxpayer states that its purchase of tangible personal property to be incorporated into realty which would become city streets once the neighborhood project became part of the city were exempt. The relevant statute is IC § 6-2.5-5-7, which states:

> Transactions involving tangible personal property are exempt from the state gross retail tax if:
> (1) the person acquiring the property is in the construction business;
> (2) the person acquiring the property acquires it for incorporation as a material or integral part of a public street or of a public water, sewage, or other utility service;
> (3) the public street or public utility service into which the property is to be incorporated is required under a subdivision plat, approved and accepted by the appropriate Indiana political subdivision; and
> (4) the public street or public utility is to be publicly maintained after its completion.

In the course of the protest process, Taxpayer was able to provide sufficient documentation to establish that the project in question met all four criteria of IC § 6-2.5-5-7. Therefore, Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

Taxpayer's next point of protest is in regards to amounts charged for labor and/or services on certain invoices. Taxpayer provided copies of several invoices and pointed out the portions of the invoices which its vendors charged for labor or services. Taxpayer believes that these amounts constitute non-taxable transactions and therefore should be removed from the Department's calculations of use tax due. The relevant statute is IC § 6-2.5-1-1, which states:

> (a) Except as provided in subsection (b), "unitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.
> (b) "Unitary transaction" as it applies to the furnishing of public utility commodities or services means the public utility commodities and services which are invoiced in a single bill or statement for payment by the consumer.

Next, IC § 6-2.5-1-2 states:

> (a) "Retail transaction" means a transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-1, that constitutes making a wholesale sale as described in IC 6-2.5-4-2, or that is described in any other section of IC 6-2.5-4.
> (b) "Retail unitary transaction" means a unitary transaction that is also a retail transaction.

Also, IC § 6-2.5-4-1(e) provides:

> The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:
> (1) the price of the property transferred, without the rendition of any service; and
> (2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records. For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.
> (Emphasis added).

Also, in Frame Station, Inc. v. Indiana Dep't of State Revenue, 771 N.E.2d 129 (Ind. Tax Ct. 2002), the Indiana Tax Court discussed the taxable status of services provided before or after the transfer of tangible personal property. In that case, the court stated:

> The transfer of property occurs when the buyer (1) agrees to buy property from a seller, (2) pays the purchase price, and (3) takes ownership and possession of the property. In this case, the evidence shows that customers pay the total price for their framed art when they pick it up, after all framing services have been performed. Therefore, Framemakers' services are performed prior to the transfer of property and constitute taxable retail unitary transactions under Indiana Code Section 6-2.5-4-1(e). Id. at 131. (Internal notations omitted).

Next, the Department refers to Galligan v. Indiana Dep't of State Revenue, 825 N.E.2d 467 (Ind. Tax 2005) in which the Indiana Tax Court wrote:

> As mentioned earlier, the provision of services is, generally, not taxable. As a practical matter, however, "mixed transactions" often occur where tangible personal property is sold in order to complete a service contract, or where services are provided in order to complete the sale of tangible personal property. For these mixed transactions, distinguishing the taxable sale of property from the non-taxable sale of services is often difficult. Accordingly, the legislature has set forth several parameters for imposing tax on these transactions. First, taxable property does not escape taxation merely because it is transferred in conjunction with the provision of non-taxable services. Ind. Code Ann. § 6-2.5-4-1(c)(2) (West 1994) (amended 2004). Second, services, generally outside the scope of taxation, are subject to tax to the extent the income represents "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." A.I.C. § 6-2.5-4-1(e)(2) (emphasis added). Finally, the legislature imposes tax on services that are provided in a retail unitary transaction, "a unitary transaction that is also a retail transaction." Ind. Code Ann. § 6-2.5-1-2(b) (West 1994). A unitary transaction is one which "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." Ind. Code Ann. § 6-2.5-1-1(a) (West 1994). Id. at 480-81. (Emphasis in original).

In the instant case, Taxpayer has provided invoices which do list the amounts charged for labor/services and the amounts charged for tangible personal property. However, these invoices also list a total combined charge for all aspects of the transactions. Therefore, under IC § 6-2.5-1-1, IC § 6-2.5-1-2, and as confirmed by the court in Frame Station and in Galligan, the service/labor charges to which Taxpayer refers are part of unitary transactions and are therefore subject to tax. Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

The final category under protest is in regards to transactions which Taxpayer states it has already self-remitted use tax. Taxpayer provided copies of checks, ledger entries, and invoices to show that it remitted use tax on these transactions. In the audit report, the Department acknowledges that Taxpayer did have a use tax accrual system in place and that Taxpayer did remit use tax during the audit years. After review, however, the Department is unable to agree that the documents establish that these transactions were included in the use tax payments it made during the audit years. Therefore, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

In conclusion, Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1, regarding amounts charged for labor and services in unitary transactions and for amounts claimed to have been previously paid in prior use tax payments. Taxpayer has met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c) regarding parts for the asphalt plants, out-of-state storage tank rentals, paving services performed for an Indiana municipality, and installation of streets which would become city streets in another Indiana municipality. Also, while Information Bulletin 60 is incorrect when it states that pavers are exempt from sales and use taxes, the Department will not impose use tax on the purchases of pavers and their repair parts by Taxpayer during the audit period. The Department reiterates that the purchase of pavers and repair parts for pavers are taxable and Information Bulletin 60 will not be considered valid on this topic as of the publication date of this Letter of Findings. Therefore, the amounts included as taxable regarding purchases or rentals of asphalt plant parts, out-of-state storage tanks, paving services for an Indiana municipality, installation of streets which became part of another Indiana municipality, and parts for pavers will be reclassified as non-taxable. The Department will then recalculate Taxpayer's compliance rate and will apply that new rate to Taxpayer's total purchases. The resulting amount will be reduced by the amount of use tax previously remitted, as was done during the audit. The Department will then send out new billings for the remaining amount of use tax due for the tax years.

FINDING

Taxpayer's protest is sustained in part and denied in part, as provided above.

II. Tax Administration–Penalties.

DISCUSSION

Taxpayer protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Taxpayer believes that its use tax compliance record is very good and that any amounts of use tax due as a result of this audit and protest is minimal. Penalty waiver is permitted if the taxpayers show that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> "Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at 45 IAC 15-11-2(c) as follows:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
>
> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
>
> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

After review of the documentation and analysis provided in the protest process, the Department finds that Taxpayer substantially complied with its duty to remit use tax as required under IC § 6-8.1-5-4(a). Taxpayer has affirmatively established that it exercised ordinary business care in this case. Therefore, waiver of penalties is warranted under 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest to the imposition of penalties is sustained.

SUMMARY

Taxpayer's Issue I protest regarding the imposition of use tax is sustained in part and denied in part. Taxpayer's Issue II protest regarding the imposition of penalties is sustained.

Posted: 08/31/2016 by Legislative Services Agency
An html version of this document.